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TAXES HAVE BEEN GOING UP: LOSS OF THE FEDERAL TAX REDUCTION

June 1987

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WHY YOUR TAXES HAVE BEEN GOING UP: LOSS OF THE FEDERAL TAX REDUCTION

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WHY YOUR TAXES HAVE BEEN GOING UP: LOSS OF THE FEDERAL TAX REDUCTION

Budget Changes

The federal tax reduction was instituted in 1973 to increase disposable income in order to stimulate consumer spending. The design of the tax reduction has since been changed several times, in recent years to limit its cost as part of Ottawa's efforts at financial restraint.

In 1982 and 1983, the federal tax reduction was calculated as the lesser of basic federal tax or \$200, plus any spouse's unused federal tax reduction, to a maximum of \$200 for a single taxfiler and \$400 for a couple. The April 1983 Budget of Finance Minister Lalonde cut the tax reduction to \$100 per person (up to \$200 per couple) for 1985 and \$50 per tax-filer (up to \$100 per couple) for the 1986 and subsequent tax years. In addition, starting in 1984, the federal tax reduction was eliminated for higher-income taxpayers; the amount of the tax reduction was diminished by 10 percent of basic federal tax over \$6,000. Finance Minister Wilson's May 1985 Budget went the final step and eliminated the federal tax reduction in 1986.

The Effects of Eliminating the Federal Tax Reduction

The third column of Table 1 shows the basic federal tax paid in 1986 by one-earner couples with two children. If the federal tax reduction in fact had not been cut, it would have paid a maximum of \$100 per family. The second column, then, gives basic federal tax with the federal tax reduction as if the latter had been retained. The last column calculates the percentage increase in basic federal tax as a result of the elimination of the federal tax reduction.

Table 1

Impact of Elimination of Federal Tax Reduction, One-Earner Couple With Two Children, by Earnings, 1986

Employment Earnings	Basic Federal Tax		Percentage Increase
	with federal tax reduction	without federal tax reduction	
\$ 10,000	\$ 0	\$ 37	-
15,000	665	765	15.0%
20,000	1,551	1,651	6.4
25,000	2,481	2,581	4.0
30,000	3,054	3,154	3.3
35,000	4,110	4,210	2.4
40,000	5,252	5,352	1.9
45,000	6,466	6,515	0.8
50,000	7,677	7,677	0.0

The \$15,000 family experienced a sizeable 15 percent tax hike because of the loss of the federal tax reduction. The higher the couple's income, the less the tax increase. Past a certain point (\$47,067), families no longer would qualify for the federal tax reduction.

Table 2 extends the analysis to indicate what tax the families would pay under three federal tax reduction options - the 1984 rate (maximum \$400 per family), the 1985 rate (maximum \$200 per family) and the 1986 rate (up to \$100 per family) which would have applied if the May 1985 Budget had not abolished the federal tax reduction. For sake of convenience these three federal tax reduction rates are referred to as Options A, B, and C, respectively.

Table 2

Basic Federal Tax, One-Earner Couple With Two Children, by Federal Tax Reduction Option and Earnings, 1986 Tax Year

Employment Earnings	Basic Federal Tax	Federal Tax Reduction Option			Net Tax		
		A	B	C	A	B	C
\$ 10,000	\$ 37	\$ 37	\$ 37	\$ 37	\$ 0	\$ 0	\$ 0
15,000	765	400	200	100	365	565	665
20,000	1,651	400	200	100	1,251	1,451	1,551
25,000	2,581	400	200	100	2,181	2,381	2,481
30,000	3,154	400	200	100	2,754	2,954	3,054
35,000	4,210	400	200	100	3,810	4,010	4,110
40,000	5,352	400	200	100	4,952	5,152	5,252
45,000	6,515	349	149	49	6,166	6,366	6,466
50,000	7,677	232	32	0	7,445	7,645	7,677
80,000	16,102	0	0	0	16,102	16,102	16,102
100,000	22,426	0	0	0	22,426	22,426	22,426

A one-earner couple with two children and an income of \$15,000 - \$6,665 below the \$21,665 low-income line in 1986 for a metropolitan center - paid basic federal tax of \$765. The federal tax reduction under Option A would lower its 1986 federal tax bill by \$400, to \$365. The family would pay \$565 in net (i.e., after the tax reduction) federal taxes under Option B and \$665 under Option C.

However, as Canadians discovered as they filled out their 1986 tax forms, they no longer benefit from the federal tax reduction. The \$20,000 family's basic federal tax came to \$1,651 because it could not deduct \$400 as in Option A, \$200 for Option B or \$100 if Option C were in effect.



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As stated above, starting in 1984 the federal tax reduction was restricted to low and middle-income taxpayers. If Option A were in effect in 1986, the maximum federal tax reduction for one-earner couples with two children (\$400 per family) would go to families with earnings below \$42,808, which is about the average; a smaller tax reduction would be available to those earning between \$42,809 and \$58,337 and the reduction would disappear above \$58,337. Option B, worth up to \$200 per family, would pay the full federal tax reduction to couples with two children earning up to \$42,808 (the same as Option A) but eligibility would end above \$51,169. Under Option C, the maximum tax reduction would end at \$42,808 and partial benefits at \$47,067.

The changes to the federal tax reduction since 1984 have hurt low and middle-income taxpayers, the working poor most of all.

